

3Q2016 IAC Meeting Materials

IAC Meeting – November 15, 2016

Presentation

Emerging Markets Manager Search



Emerging Markets Manager Search

November 15, 2016

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Agenda

- Emerging Markets (“EM”) Overview
- Emerging Markets Manager Search
 - Objectives and Search Criteria
 - Emerging Markets Manager Summaries
 - Comparative Analysis
 - Recommendation and Implementation

Emerging Markets Overview

The Callan Periodic Table of Investment Returns

Annual Returns for Key Indices Ranked in Order of Performance (1996–2015)

1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
S&P 500 Growth	S&P 500 Growth	S&P 500 Growth	MSCI Emerging Markets	Russell 2000 Value	Russell 2000 Value	Barclays Agg	MSCI Emerging Markets	MSCI Emerging Markets	MSCI Emerging Markets	MSCI Emerging Markets	MSCI Emerging Markets	Barclays Agg	MSCI Emerging Markets	Russell 2000 Growth	Barclays Agg	MSCI Emerging Markets	Russell 2000 Growth	S&P 500 Growth	S&P 500 Growth
23.97%	36.52%	42.16%	66.42%	22.83%	14.02%	10.26%	56.28%	25.95%	34.54%	32.59%	39.78%	5.24%	79.02%	29.09%	7.84%	18.63%	43.30%	14.89%	5.52%
S&P 500	S&P 500	S&P 500	Russell 2000 Growth	Barclays Agg	Barclays Agg	Barclays Corp High Yield	Russell 2000 Growth	Russell 2000 Value	MSCI EAFE	MSCI EAFE	MSCI EAFE	Barclays Corp High Yield	Barclays Corp High Yield	Russell 2000	Barclays Corp High Yield	Russell 2000 Value	Russell 2000	S&P 500	S&P 500
22.96%	33.36%	28.58%	43.09%	11.63%	8.43%	-1.41%	48.54%	22.25%	13.54%	26.34%	11.17%	-26.16%	58.21%	26.85%	4.98%	18.05%	38.82%	13.69%	1.38%
S&P 500 Value	Russell 2000 Value	MSCI EAFE	S&P 500 Growth	S&P 500 Value	Barclays Corp High Yield	MSCI Emerging Markets	Russell 2000	MSCI EAFE	S&P 500 Value	Russell 2000 Value	S&P 500 Growth	Russell 2000 Value	Russell 2000 Value	Russell 2000 Value	S&P 500 Growth	S&P 500 Value	Russell 2000 Value	S&P 500 Value	Barclays Agg
22.00%	31.78%	20.00%	28.24%	6.08%	5.28%	-6.00%	47.25%	20.25%	5.82%	23.48%	9.13%	-28.92%	34.47%	24.50%	4.65%	17.68%	34.52%	12.36%	0.55%
Russell 2000 Value	S&P 500 Value	S&P 500 Value	MSCI EAFE	Russell 2000	Russell 2000	Russell 2000 Value	Russell 2000 Value	Russell 2000	S&P 500	S&P 500 Value	Russell 2000 Growth	Russell 2000	MSCI EAFE	MSCI Emerging Markets	S&P 500	MSCI EAFE	S&P 500 Growth	Barclays Agg	MSCI EAFE
21.37%	29.98%	14.69%	26.96%	-3.02%	2.49%	-11.45%	46.03%	18.33%	4.91%	20.81%	7.05%	-33.79%	31.78%	19.20%	2.11%	17.32%	32.75%	5.97%	-0.81%
Russell 2000	Russell 2000	Barclays Agg	Russell 2000	Barclays Corp High Yield	MSCI Emerging Markets	MSCI EAFE	MSCI EAFE	S&P 500 Value	Russell 2000 Value	Russell 2000	Barclays Agg	S&P 500 Growth	S&P 500 Growth	Barclays Corp High Yield	S&P 500 Value	Russell 2000	S&P 500	Russell 2000 Growth	Russell 2000 Growth
16.49%	22.36%	8.70%	21.26%	-5.86%	-2.37%	-15.94%	38.59%	15.71%	4.71%	18.37%	6.97%	-34.92%	31.57%	15.12%	-0.48%	16.35%	32.39%	5.60%	-1.38%
Barclays Corp High Yield	Russell 2000 Growth	Barclays Corp High Yield	S&P 500	S&P 500	Russell 2000 Growth	Russell 2000	S&P 500 Value	Russell 2000 Growth	Russell 2000	S&P 500	S&P 500	S&P 500	Russell 2000	S&P 500 Value	Russell 2000 Growth	S&P 500	S&P 500 Value	Russell 2000	S&P 500 Value
11.35%	12.95%	1.87%	21.04%	-9.11%	-9.23%	-20.48%	31.79%	14.31%	4.55%	15.79%	5.49%	-37.00%	27.17%	15.10%	-2.91%	16.00%	31.99%	4.89%	-3.13%
Russell 2000 Growth	Barclays Corp High Yield	Russell 2000 Growth	S&P 500 Value	MSCI EAFE	S&P 500 Value	S&P 500 Value	Barclays Corp High Yield	Barclays Corp High Yield	Russell 2000 Growth	Russell 2000 Growth	S&P 500 Value	Russell 2000 Growth	S&P 500	S&P 500	Russell 2000	Barclays Corp High Yield	MSCI EAFE	Russell 2000 Value	Russell 2000
11.26%	12.76%	1.23%	12.73%	-14.17%	-11.71%	-20.85%	28.97%	11.13%	4.15%	13.35%	1.99%	-38.54%	26.47%	15.06%	-4.18%	15.81%	22.78%	4.22%	-4.41%
MSCI EAFE	Barclays Agg	Russell 2000	Barclays Corp High Yield	S&P 500 Growth	S&P 500	S&P 500	S&P 500	S&P 500	S&P 500 Growth	Barclays Corp High Yield	Barclays Corp High Yield	S&P 500 Value	S&P 500 Value	S&P 500 Growth	Russell 2000 Value	S&P 500 Growth	Barclays Corp High Yield	Barclays Corp High Yield	Barclays Corp High Yield
6.05%	9.64%	-2.55%	2.39%	-22.08%	-11.89%	-22.10%	28.68%	10.88%	4.00%	11.85%	1.87%	-39.22%	21.17%	15.05%	-5.50%	14.61%	7.44%	2.45%	-4.47%
MSCI Emerging Markets	MSCI EAFE	Russell 2000 Value	Barclays Agg	Russell 2000 Growth	S&P 500 Growth	S&P 500 Growth	S&P 500 Growth	S&P 500 Growth	Barclays Corp High Yield	S&P 500 Growth	Russell 2000	MSCI EAFE	Russell 2000 Value	MSCI EAFE	MSCI EAFE	Russell 2000 Growth	Barclays Agg	MSCI Emerging Markets	Russell 2000 Value
6.03%	1.78%	-6.45%	-0.82%	-22.43%	-12.73%	-23.59%	25.66%	6.13%	2.74%	11.01%	-1.57%	-43.38%	20.58%	7.75%	-12.14%	14.59%	-2.02%	-1.82%	-7.47%
Barclays Agg	MSCI Emerging Markets	MSCI Emerging Markets	Russell 2000 Value	MSCI Emerging Markets	MSCI EAFE	Russell 2000 Growth	Barclays Agg	Barclays Agg	Barclays Agg	Barclays Agg	Russell 2000 Value	MSCI Emerging Markets	Barclays Agg	Barclays Agg	MSCI Emerging Markets	Barclays Agg	MSCI Emerging Markets	MSCI EAFE	MSCI Emerging Markets
3.64%	-11.59%	-25.34%	-1.49%	-30.61%	-21.44%	-30.26%	4.10%	4.34%	2.45%	4.33%	-9.78%	-53.18%	5.93%	6.54%	-18.17%	4.21%	-2.27%	-4.90%	-14.60%

Overview

Emerging Markets

- **2000-2012: Golden period for emerging markets**
 - Low interest rates in developed countries led to large inflows to emerging markets
 - China growth => commodities boom
 - Growth across all countries
- **2012- : Uncertain era**
 - Easy monetary policy is ending
 - Commodities prices are depressed
 - Population growth: opportunity or threat?
 - Sustained economic growth is hard to achieve
 - **Expect overall lower economic growth**
 - **Uneven growth: winners and losers**

Market Cap Return Dispersion (15 years)

- ▶ EM Small-Cap has outperformed EM Large-Cap since 2001

	MSCI EM SC (%)	MSCI EM (%)	Difference
2001	0.2	-2.4	2.6
2002	-1.5	-6.0	4.5
2003	60.4	56.3	4.1
2004	24.7	25.9	-1.2
2005	29.2	34.5	-5.3
2006	32.4	32.6	-0.2
2007	42.3	39.8	2.5
2008	-58.2	-53.2	-5.0
2009	113.8	79.0	34.8
2010	27.2	19.2	8.0
2011	-27.2	-18.2	-9.0
2012	22.2	18.6	3.6
2013	1.0	-2.3	3.3
2014	1.0	-1.8	2.8
2015	-6.9	-14.6	7.7

Style Dispersion (15 years)

- ▶ EM Growth has outperformed EM Value since 2010

	MSCI EM Growth (%)	MSCI EM Value (%)	Difference
2001	-6.6	1.5	-8.1
2002	-7.7	-4.5	-3.2
2003	49.3	62.3	-13.0
2004	20.6	30.7	-10.1
2005	35.0	33.0	2.0
2006	32.5	32.0	0.5
2007	36.7	42.2	-5.5
2008	-56.3	-50.3	-6.0
2009	77.9	79.1	-1.2
2010	19.3	18.4	0.9
2011	-19.0	-17.9	-1.1
2012	20.6	15.9	4.7
2013	-0.2	-5.1	4.9
2014	-0.4	-4.1	3.7
2015	-11.3	-18.6	7.3



Emerging Markets Manager Search

Search Objectives and Criteria

Objectives

- Diversify and reduce asset concentration within current manager program

Criteria

- Excess returns that are diversifying to international emerging markets managers
- Stable investment team
- Firm size assets of \$1 billion or greater
- Product assets of \$500 million or greater
- Good long-term performance
- Open to new accounts



Emerging Markets Manager Summaries

Delaware Investments

1) Organization

- Publicly owned – subsidiary of Macquarie Group Limited
- Total firm assets under management - \$174 billion
- Total assets in emerging markets product - \$3.9 billion

2) Team

- One lead portfolio manager with over 20 years of investment experience
- Three dedicated research analysts

3) Investment Process

- Fundamental, bottom-up stock selection
- Focus on companies with sustainable franchises that are trading below intrinsic value
- Position weightings in the portfolio are based on their conviction in the company's franchise and in its discount relative to its intrinsic value
- Relative value
- Overweight to large-cap stocks

Delaware Investments (cont.)

4) Portfolio Construction/Risk Management

- Well-diversified portfolio with 90-140 stocks
- Low annual portfolio turnover: 12% in 2015
- Five year realized tracking error is 5.10%

5) Manager Provides Diversification Benefits

6) Additional Items of Note

- Key man risk with Portfolio Manager Liu-Er Chen
- Long term focus, there could be some long periods of underperformance

7) Standard Fee Structure →

Assets	Fee
First \$50 million	1.10%
Next \$50 million	0.90%
Next \$100 million	0.75%
Balance	0.60%

EARNEST Partners

1) Organization

- 100% employee owned
- Total firm assets under management - \$19.5 billion
- Total assets in Emerging Markets - \$770 million in dedicated strategies and additional \$1.8 billion through the international product

2) Team

- Six portfolio managers (shared with other products) with an average of 10 years of investment experience
- Eight research analysts (shared with other products)

3) Investment Process

- Fundamental, bottom-up stock selection
- Proprietary screening tool called “Return Pattern Recognition”
 - Screen the universe to identify stocks that will outperform based on their financial characteristics and the current environment; customized parameters for each sector
- Relative value
- All cap strategy: provides exposure to smaller stocks in the universe

EARNEST Partners (cont.)

4) Portfolio Construction/Risk Management

- Concentrated portfolio: 40–60 stocks
- Low annual portfolio turnover: 6% in 2015
- Five year realized tracking error is 4.71%

5) Manager Provides Diversification Benefits

6) Additional Items of Note

- Use China A Share in the unconstrained version of the strategy

7) Standard Fee Structure →

Assets	Fee
First \$50 million	1.00%
Next \$60 million	0.90%
Next \$80 million	0.80%
Balance	0.70%

Martin Currie Investment Management, Ltd

1) Organization

- Investment boutique owned by Legg Mason
- Total firm assets under management - \$12 billion
- Total assets in emerging markets product - \$1.1 billion

2) Team

- Seven portfolio managers fully dedicated to the strategy; portfolio managers are responsible for research
 - Have worked together since 2001 at previous firm; since 2010 at Martin Currie

3) Investment Process

- Fundamental, bottom-up stock selection
- Focus on cash-flows that will be sustainable and in excess of cost of capital
 - Apply specific costs of capital for each country in valuation models based on political and economic risk
- Growth at Reasonable Prices ("GARP")
- Overweight to large-cap stocks

Martin Currie Investment Management, Ltd (cont.)

4) Portfolio Construction/Risk Management

- Concentrated portfolio: 40-60 stocks
- Annual turnover: 22% in 2015
- Five year realized tracking error is 3.33%

5) Manager Provides Diversification Benefits

6) Additional Items of Note

- Environmental, Social, Governance (“ESG”) factors are included in their analysis

7) Standard Fee Structure →

Assets	Fee
First \$50 million	0.75%
Balance	0.65%

Neuberger Berman

1) Organization

- 100% employee owned
- Total firm assets under management - \$246 billion
- Total assets in emerging markets product - \$4.6 billion

2) Team

- One portfolio manager; joined the firm in 2008
- Four research analysts, fully dedicated to the product

3) Investment Process

- Fundamental, bottom-up stock selection
- Focus on growing companies with sustainable ROE, minimal debt and attractive valuation
- GARP
- All cap strategy: provides exposure to smaller stocks in the universe

Neuberger Berman (cont.)

4) Portfolio Construction/Risk Management

- Well diversified portfolio: 80-110 stocks
- Annual turnover: 42% in 2015
- Five year realized tracking error is 3.86%

5) Manager Provides Diversification Benefits

6) Standard Fee Structure →

Assets	Fee
First \$25 million	1.00%
Next \$25 million	0.90%
Next \$150 million	0.85%
Balance	0.75%

Pzena Investment Management, LLC

1) Organization

- Ownership: 76% by employees (current and former); 24% public ownership
- Total firm assets under management - \$25 billion
- Total assets in emerging markets product - \$1.8 billion

2) Team

- Four portfolio managers (shared); portfolio managers are also responsible for research
- Nineteen research analysts (shared)

3) Investment Process

- Fundamental, bottom-up stock selection
- Companies are ranked into quintiles by Price/Normalized Earning; focus on the cheapest quintile and companies experiencing temporary problems
- Deep value
- All cap strategy: provides exposure to smaller stocks in the universe

Pzena Investment Management, LLC (cont.)

4) Portfolio Construction/Risk Management

- Concentrated portfolio: 40-80 stocks
- Annual turnover: 35% in 2015
- Five year realized tracking error is 5.24%

5) Manager Provides Diversification Benefits

6) Standard Fee Structure →

Assets	Fee
First \$50 million	1.00%
Balance	0.70%

The Rock Creek Emerging Markets Group

1) Organization

- Joint Venture: Rock Creek employees own 35% and Wells Fargo (through AMD) owns remaining 65%
- Total firm assets under management - \$12 billion
- Total assets in emerging markets product - \$2.8 billion

2) Team

- Three portfolio managers and three research analysts
- Local investment managers

3) Investment Process

- Top-down (Rock Creek) and bottom-up (local investment managers)
- Small and mid-cap companies provide the best exposure to local and regional economic factors within emerging markets
- GARP
- All cap strategy: provides exposure to smaller stocks in the universe

The Rock Creek Emerging Markets Group (cont.)

4) Portfolio Construction/Risk Management

- Well diversified portfolio: 842 stocks
- Annual turnover: 68% in 2015
- Five year realized tracking error is 4.13%

5) Manager Provides Diversification Benefits

6) Additional Items of Note

- Fund of Funds Structure

7) Standard Fee Structure

- Inclusive of Underlying Manager Fees →

Assets	Fee
Balance	1.25%



Emerging Markets Managers Comparative Analysis

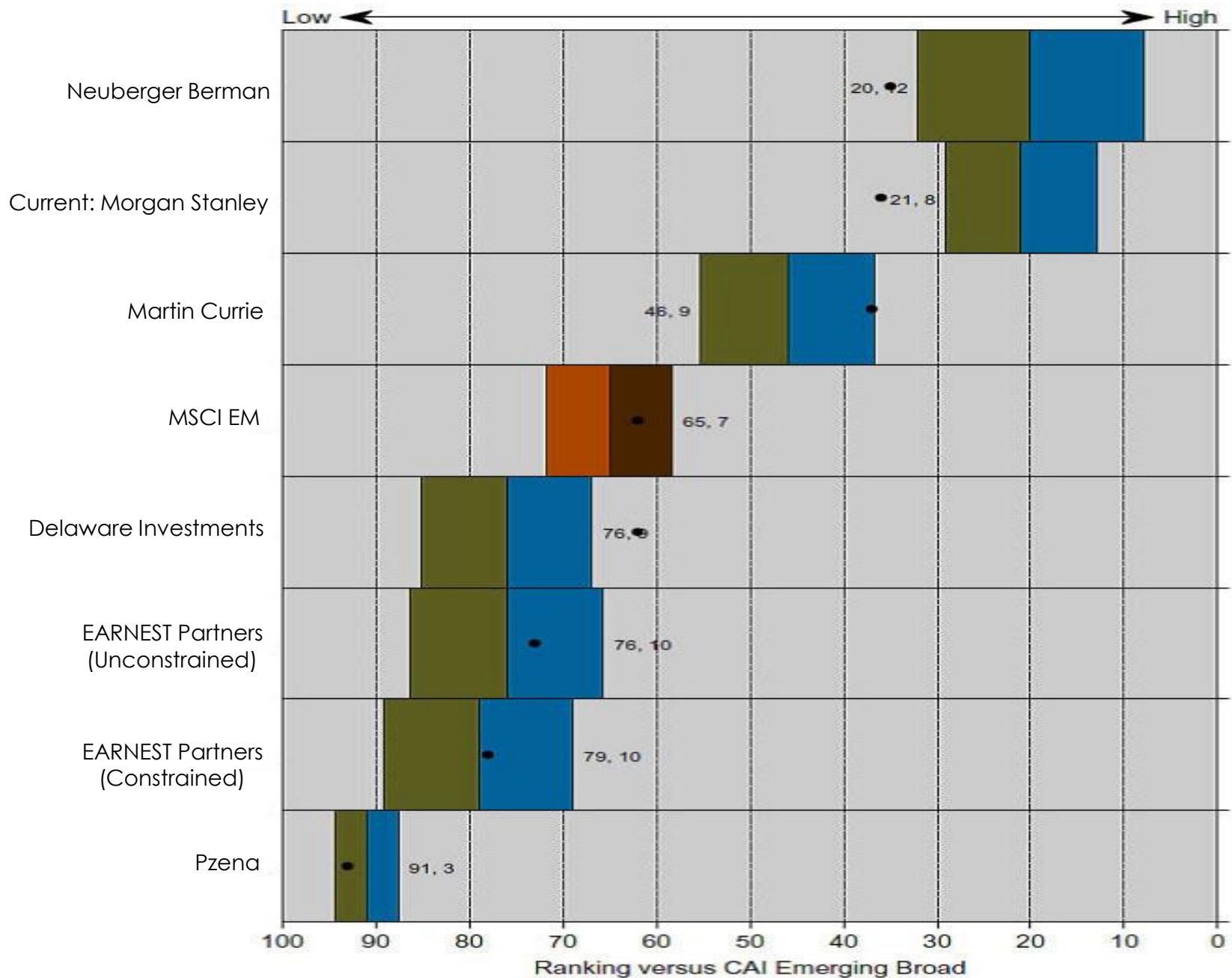
Summary

Key Characteristics

Firm	Delaware	Earnest Partners	Martin Currie	Neuberger Berman	Pzena	Rock Creek
Inception Date	Oct. 2005	Sept. 2004	Oct. 2010	Feb. 1997	Jan. 2008	Aug. 2009
Team Based	Boston	Atlanta	Edinburgh, Scotland	New York	New York	Washington, D.C.
Style	Relative Value	Relative Value	GARP	GARP	Deep Value	GARP
AUM (6/30/2016)	\$3.9 billion	\$639 million	\$1.1 billion	\$4.6 billion	\$1.8 billion	\$2.8 billion
Star PM/Team	Star PM	Team	Team	Star PM/Team	Team	Team
Team's Tenure	Since 2006 at Delaware, since 2001 at prior firm	Since inception in 2004	Since 2010 at Martin Currie, since 2001 at prior firm	Since 2008	Since inception in 2008	Since inception in 2009
# of Holdings	95	53	54	101	59	842
Size	Large-Cap	All Cap	Large-Cap	All Cap	All Cap	All Cap
Bottom-up or Top-down	Bottom-up	Bottom-up	Bottom-up	Bottom-up	Bottom-up	Top-down and Bottom-up

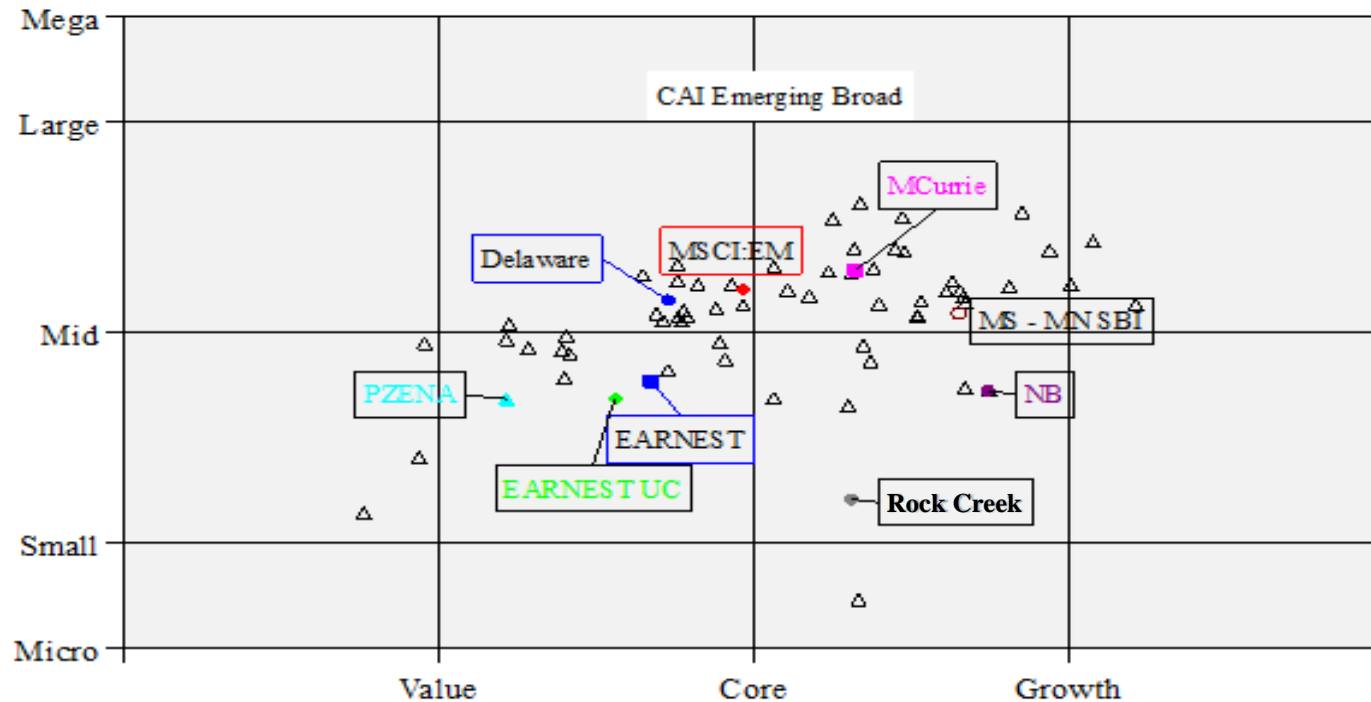
Growth Relative to Value Rankings

For Five Years Ended June 30, 2016



Style Value, Core, Growth

International Equity Style Map
for 5 Years Ended June 30, 2016





Recommendation & Implementation

Recommendation and Implementation

Recommendation

Staff recommends retaining up to six of the following firms:

- Delaware Investments
- EARNEST Partners
- Martin Currie Investment Management, Ltd.
- Neuberger Berman
- Pzena Investment Management, LLC
- Rock Creek Emerging Markets Group

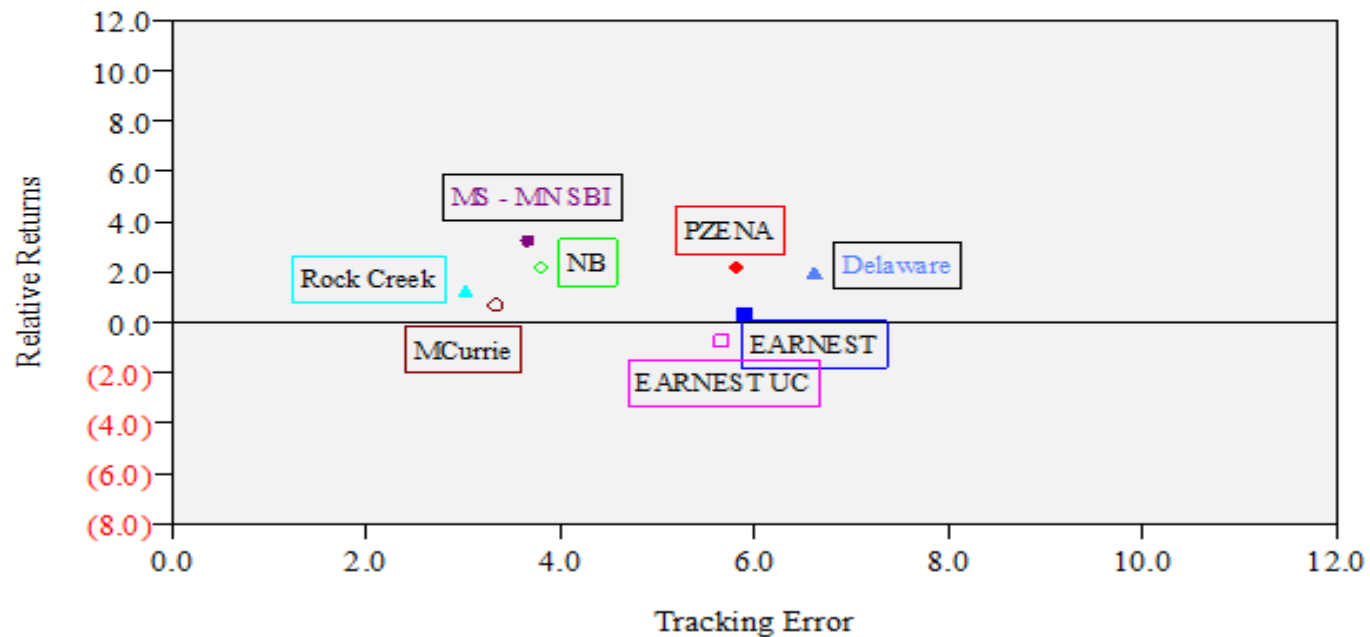
Implementation by Staff

- 1) Negotiate fee schedule with each manager
 - Performance base fees may or may not be part of the fee schedule
- 2) Account size to be determined by Executive Director

Appendix

Risk and Return

Scatter Chart
for 5 Years Ended June 30, 2016
Benchmark: MSCI:EM
using Gross of Fee Returns



Correlation Matrix

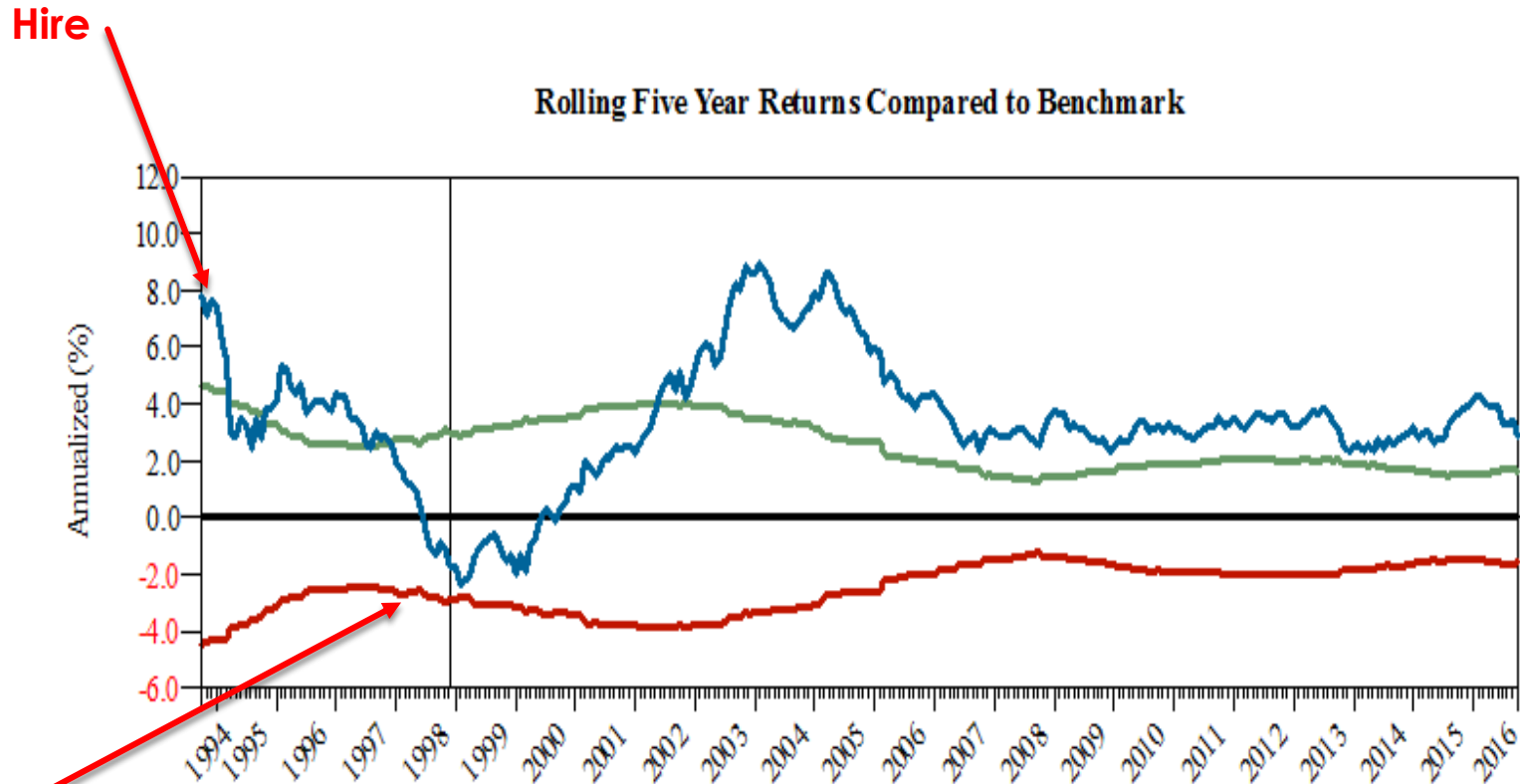
Excess Correlation Table
 (monthly returns)
 Benchmark: MSCI:EM
 for 5 Years Ended June 30, 2016

MS - MN SEI	1.0000							
Delaware	(0.0800)	1.0000						
EARNEST	(0.2673)	0.1944	1.0000					
EARNEST UC	(0.2296)	0.0858	0.9070	1.0000				
MCurrie	0.1747	0.1490	(0.1662)	(0.1694)	1.0000			
NB	0.5282	0.1378	(0.1777)	(0.1023)	0.3211	1.0000		
PZENA	(0.0104)	0.4046	(0.0166)	(0.1183)	(0.0559)	(0.0118)	1.0000	
Rock Creek	0.6512	0.1157	(0.1059)	(0.0084)	0.2443	0.7093	0.0769	1.0000
	MS - MN SEI	Delaware	EARNEST	EARNEST UC	MCurrie	NB	PZENA	Rock Creek

Reversion to the Mean (I)

- **Negative Selection Cycle:**
 - Human nature leads to hiring the manager with the best recent performance presented in a search
 - The inherent biases or portfolio positioning that lead to the outperformance often lead to a subsequent underperformance
 - The manager with weak relative returns over a two or three year period is replaced with another manager with strong relative returns
 - This negative selection cycle can result in significant underperformance of the asset class benchmark and peer universe

Reversion to the Mean (II)

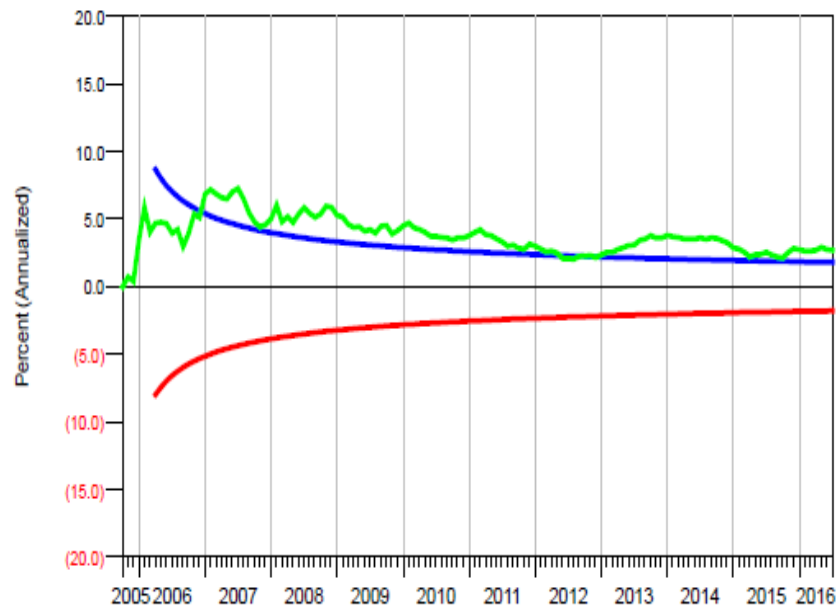


Termination

Emerging Markets Managers Returns

Delaware Investments

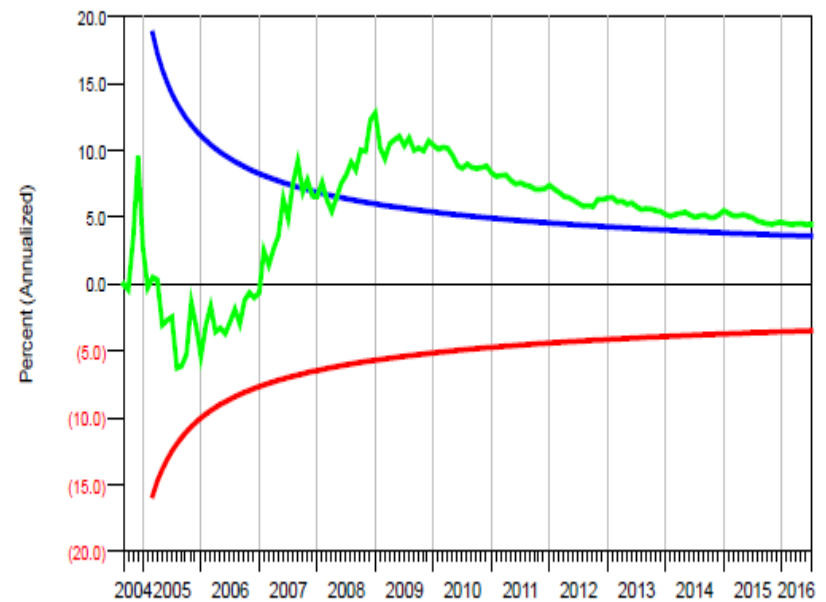
Cumulative VAM
Since Inception



80% Confidence Interval

EARNEST Partners (unconst.)

Cumulative VAM
Since Inception

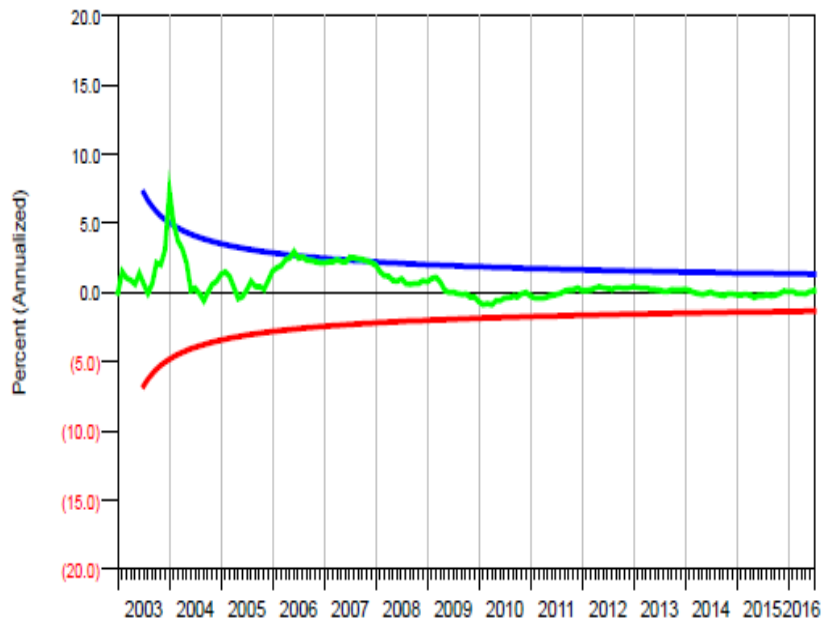


80% Confidence Interval

Emerging Markets Managers Returns

Martin Currie

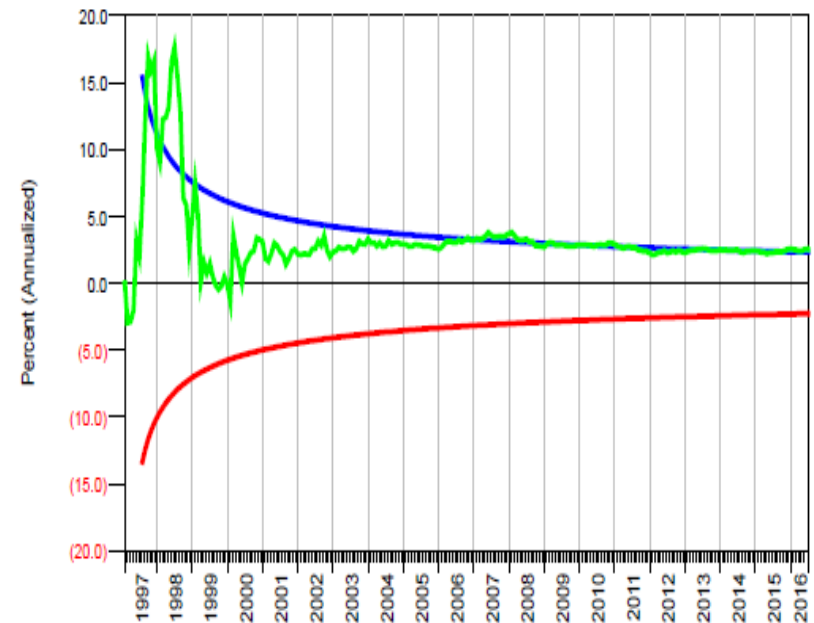
Cumulative VAM
Since Inception



80% Confidence Interval

Neuberger Berman

Cumulative VAM
Since Inception

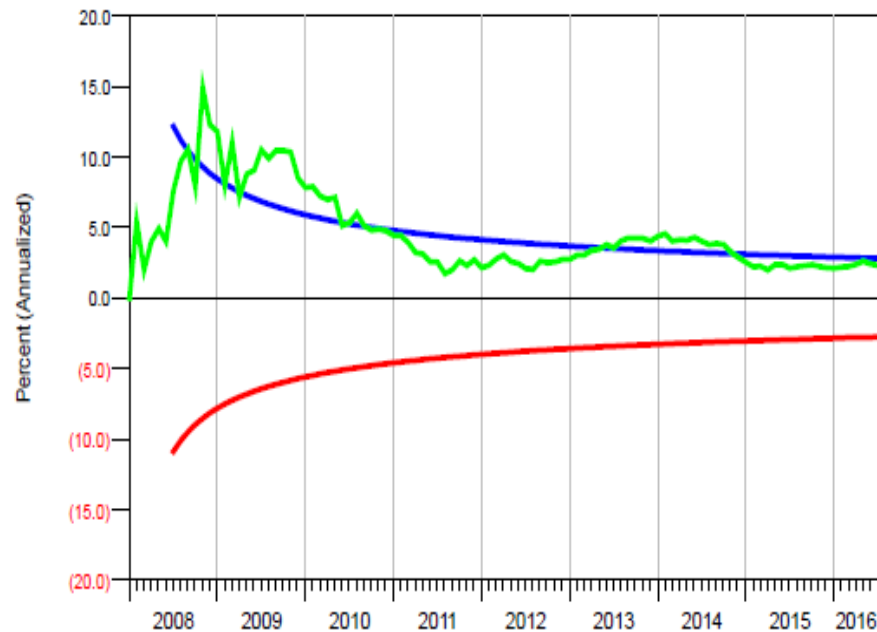


80% Confidence Interval

Emerging Markets Managers Returns

Pzena

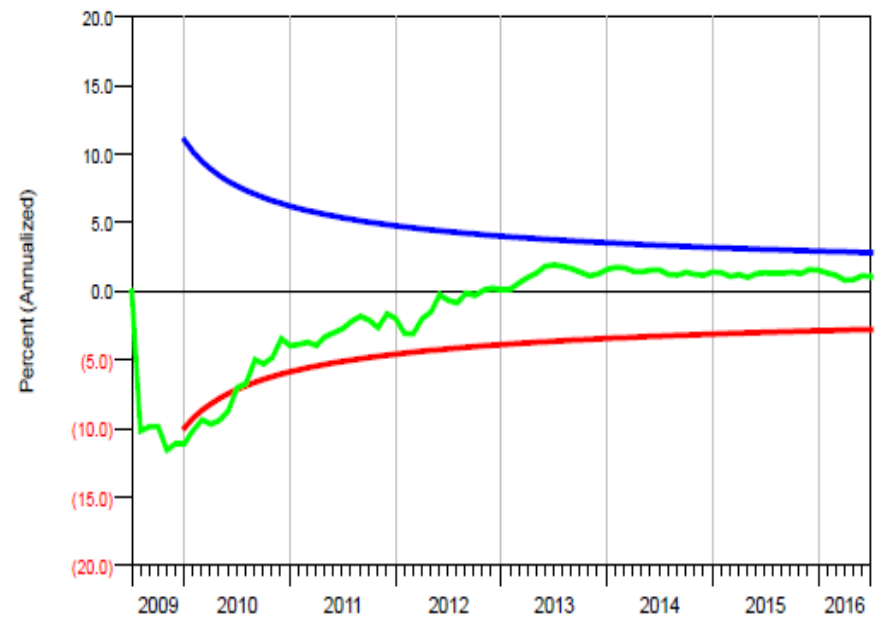
Cumulative VAM
Since Inception



80% Confidence Interval

Rock Creek

Cumulative VAM
Since Inception



80% Confidence Interval